

2010 COMPETITIVE BID HEARINGS

**Findings and Recommended Rental Rates for
Agricultural and Grazing Lease Nos.**

**10403, 8978, 7297, 8254, and
State Grazing License No. 3062986**

**A report to the State Board of Land Commissioners by
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Montana Department of Natural Resources and Conservation
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TABLE OF CONTENTS

Agricultural and Grazing Lease Nos.

10403 - Lessee: Joe Juve; High Bidder: James Lossing, Jr.	6
8978 - Lessee: Anna Nyquist Ranch, LLP; High Bidder: John Nyquist.....	7
7297 - Lessee: Robert & Russell Zinda; High Bidder: Rex Knight, Jr.....	9
8254 - Lessee: George & Wyatt Wood; High Bidder: Joshua Billmayer.....	10
7272 - Lessee: Mark & Julie Young; High Bidder: Roger Jones (POSTPONED).....	11
State Grazing License No. 3062986	
Licensee: Rod & Tom Vannoy Ranch Company; High Bidder: Tom Ide.....	12

On April 23, 2010 the Department recently held Competitive Bid Hearings for State of Montana Agricultural and Grazing Leases Nos. 10403, 8978, 7297, 8254, 7272, and State Grazing License No. 3062986, which are being renewed in 2010. These new ten-year leases will expire on February 28, 2020. If a Lessee wishes to renew the lease for another term he must submit an application. If other persons inquire about the availability of a lease, their names and addresses are noted in the file and they are sent applications and bid forms at the time of lease renewal.

The statutory absolute preference right within Section 77-6-205(2), MCA, to renew a State agricultural and grazing lease was declared unconstitutional by Judge Jeffrey Sherlock in Broadbent v. State of Montana, et al., First Mont. Judic. Distr. Ct., Cause No. BDV-2003-361, because it impermissibly interfered with the constitutional power of the Land Board, under Art. X, Section 4 of the Montana Constitution, to choose its lessees. The Land Board, in response to Judge Sherlock's ruling, amended ARM 36.25.117 to exercise its constitutional prerogative to grant a qualified preference right to incumbent lessees in good standing. Through this rule, the Land Board has expressed its qualified preference to issue renewals of agricultural and grazing leases to the incumbent lessee provided that they have not committed illegal subleasing and do not have a history of lease violations. However, in all instances, the Board has reserved the right to choose the best-qualified lessee.

As part of its constitutional power, the Land Board may also determine the rate at which such leases will be issued. The Land Board has recognized that full market value encompasses the concept of sustained yield. Section 77-6-101 MCA. In Jerke v. State Dept. of Lands, 182 Mont. 294, at 296-297, 597 P.2d 49 at 50-51 (1979), the Montana Supreme Court held that a Grazing District which was not a lessee of a state grazing lease could not exercise a preference right. The Court described the rationale of the preference right to meet a high bid as follows:

Sustained yield is the policy which favors the long term productivity of the land over the short term return of income. State ex rel. Thompson v. Babcock, supra. The preference right seeks to further this policy by inducing the State's lessees to follow good agricultural practices and make improvements on the land. This is accomplished by guaranteeing that the lessees will not lose the benefits of their endeavors by being outbid when their leases terminate. They are preferred and may renew their leases by meeting the highest bid submitted.

Id.

Exercised in such a manner, such a preference is in the best financial interests of the school trust beneficiaries. All other things being equal, the Land Board has recognized that stability of land tenure encourages existing lessees to make greater improvements in the land, knowing that they will likely be able to utilize these improvements in the future, and that stability of tenure allows lessees to operate more efficiently. The duty to maximize revenue return to the trust estate from the trust properties is always subject to the duty to preserve the financial productivity of the trust lands. Oklahoma Education Association v. Nigh, 642 P.2d 230 at 238 (1982)

No Applicant for a grazing lease can compel the State Board of Land Commissioners to grant it an interest in state trust lands, especially where the concept of sustained yield is ignored. See, Skillman v. Department of State Lands, 188 Mont. 383, 613 P.2d 1389 (1980); Gibson v. Stewart, 50 Mont. 404, 147 P. 276 (1915)(Whether a tract of state land shall be leased is a question addressed to the sole discretion of the Land Board.); §77-6-206, MCA ([T]he board may withdraw any agricultural or grazing land from

further leasing for such period as the board determines to be in the best interest of the state”).)

Under ARM 36.25.117, if the Lessee exercises the qualified preference right but believes that the bid amount is excessive, he or she may request a hearing. The purpose of the hearing is twofold: 1) to determine the best-qualified Lessee for the upcoming lease term; and 2) to ascertain the appropriate rental rate for that term. Specifically, the Director inquires whether the high bid amount represents the fair market value of the lease and whether the rental rate is truly in the best interests of the trust. In determining whether the "high bid" rental rate is in the best interests of the beneficiaries of the trust, the Land Board must utilize the criteria set out in §77-6-205(2), MCA, and in Thompson v. Babcock, 147 Mont. 46, 409 P.2d 808 (1966). Under these criteria, the Montana Supreme Court has held that the "high bid" may be rejected where it is either "...above community standards for a lease of such land, would cause damage to the tract, or impair its long-term productivity".

The Montana Supreme Court has recognized that an excessive rental rate, at some point, economically compels a Lessee to graze all the available forage on a grazing lease or reduce costly fertilizer, herbicide, and summer fallow treatments on agricultural leases. When state lands are over-grazed or farmed with minimal input costs, they produce more noxious weeds, less forage or crops, and less future income for the beneficiaries of the various trust lands. In extreme cases, the productivity of the land may be permanently damaged. It is in the best interests of the State to set a rental rate which balances the competing factors. In this "balancing act", the Land Board is attempting to maximize long-term income by allowing the Lessee a sufficient monetary incentive to exercise wise range management and agricultural practices. If the rate is too low, the State will not receive full market value for its lands. If the rate is too high, the Lessee will be induced to over-graze the tract, or reduce inputs such as herbicides, and long-term trust income will inevitably suffer.

In the competitive bid hearing process, the Director is recommending the rental rate for the next term of the grazing or agricultural lease. The economic viability of these leases fluctuates according to prevailing weather conditions and commodity prices; both of which can vary wildly. Despite these fluctuations, the grazing rental charged by the Board must be paid by the Lessee whether or not any forage upon the lease is utilized. By contrast, private lessors generally do not collect rentals when they no longer have forage available for lease. Consequently, setting an appropriate rental rate, so as to sustain the long-term viability of "school trust" leases and maximize long-term income, is simply not as easy as accepting the highest bid. If it were, there would be no need for a hearing on the subject.

The best lessee is chosen according to nine criteria set out within ARM 36.25.117:

- 1) an intended grazing or cropland management plan for the new term of the lease;
- 2) experience associated with the classified use of the land;
- 3) other non-state lands that are fenced and managed in common with the state land;
- 4) intended grazing or cropland improvements that will benefit the health and productivity of the state lands;
- 5) a weed management plan;
- 6) management goals and objectives and monitoring procedures to determine if they are being met;
- 7) the method or route used to access the state land;
- 8) any other information the director deems necessary in order to provide a recommendation to the board; and,
- 9) the incorporation of all or part of this information as terms and conditions in the new lease agreement.

The current policy of the Board authorizes the Director of the Department to hold the competitive bid hearings; hear the evidence; and make recommendations to the board. Since the rental rates must be based upon the evidence presented at the hearing, the Board members must avoid consideration of information outside the hearing record.

This year the Director granted six requests for hearing. The hearings were conducted on April 23, 2010 at the offices of the Department in Helena, Montana. The hearing was electronically recorded and all witnesses testified under oath. However, the hearings were conducted in an informal manner. Present at one or more of the hearings were: Director Mary Sexton; Deputy Director Joe Lamson; Trust Lands Management Division Administrator Tom Schultz; Agriculture and Grazing Management Bureau Chief Kevin Chappell; Trust Lands Attorney Tommy Butler; Conrad Unit Manager Erik Eneboe; Glasgow Unit Manager Hoyt Richards; Ann Gilkey; Rusty Harper; and Canon Luerkens.

In preparation for this hearing, both the Lessee and the High Bidder were notified of the time and place of the hearing and given copies of ARM 36.25.117. When appropriate to the hearing, the Commissioner accepted in the evidentiary record, the following evidence:

1. The Department's County Competitive Grazing Lease Bid Summary for Sheridan, Valley, Wibaux, Pondera, Teton and Missoula Counties for 2009.
2. The Montana Agricultural Statistics Service Report of Grazing Fee Rates for private leases in Montana reporting an average rate of \$18.00/AUM.

The testimony and evidence considered during the hearing; a summary of the hearing; and the findings and conclusions recommended are set out as follows: